INLAND REVENUE AUTHORITY OF SINGAPORE

IRAS e-Tax Guide

GST: Guide on Due Diligence Checks to Avoid Being Involved in Missing Trader Fraud (Third Edition)

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1 Aim

1.1 This guide explains how businesses may recognise and respond to the risk indicators for a Missing Trader Fraud ("MTF") arrangement, as well as how the Knowledge Principle[1] may apply to deny a GST-registered business' input tax claims.

1.2 The examples in this guide are not exhaustive. Depending on the profile of your business and your transactions, you should undertake adequate and appropriate due diligence checks in a risk-based and proportionate manner to avoid being involved in MTF arrangements.

1.3 You should read this guide if you are or will be a GST-registered business so that you can implement practical preventive and detection measures to avoid being involved in MTF arrangements.

2 At a glance

2.1 MTF is a fraud scheme used by crime syndicates to defraud tax authorities of GST (or equivalent taxes) in various jurisdictions, including Singapore. Such fraud poses a serious threat to public revenue.

2.2 Under an MTF arrangement, a supplier fails to account for or pay the GST charged on his sales (this supplier is referred to as the "Missing Trader"), while businesses along the supply chain continue to claim credit of input tax or refund of GST on their purchases.

2.3 MTF relies heavily on the ability of fraudulent businesses to sell goods or services to other businesses along the chain. The other businesses along the chain may not necessarily be aware of the details of the MTF arrangement. Often, they are presented with an opportunity to make a quick financial gain and choose to turn a blind eye to the true nature of the transactions entered into. However, there will always be risk indicators that would put reasonable persons on alert that the transactions may not be what they appear to be.

2.4 From 1 Jan 2021, taxable persons will not be allowed to claim input tax on supplies made to them which they knew or should have known to be part of any arrangement to cause loss of public revenue. This rule is referred to as the "Knowledge Principle".

2.5 The Knowledge Principle aims to counter MTF by ensuring that businesses conduct proper due diligence of business deals and scrutinise the legitimacy of their purchases more carefully. Failure to do so may result in non-compliant businesses not being able to claim input tax on affected purchases.

[1] Please refer to paragraph 5 on the Knowledge Principle.

3 Glossary

3.1 Taxable person

A GST-registered person or a person who is required to register for GST.

3.2 Missing Trader

A taxable person that is usually at the beginning of the supply chain, who fails to account for or pay the GST charged on its supplies. The Missing Trader is often a shell company or bought off the shelf[2] without any tangible assets, or is a completely fictitious company. The director of the Missing Trader is often a nominee who takes instructions from another person.

3.3 Buffer

A taxable person who is placed in the supply chain between the Missing Trader and the Exporter. There can be multiple buffers in a single supply chain.

3.4 Exporter

A taxable person that is usually at the end of the supply chain, who buys goods from the buffers and exports the goods to overseas customers GST-free.

4 Background

What is Missing Trader Fraud?

4.1 An MTF arrangement is a scheme that involves goods[3] being traded under contrived supply chains. These supply chains are typically managed by a "controlling mind" who determines the price and date of each transaction. A small profit is factored in each time the goods change ownership along the supply chain, thereby increasing the GST that can be claimed by the exporter at the end of supply chain.

4.2 Under an MTF arrangement, the seller at the beginning of a supply chain (i.e. the Missing Trader) will fail to account for or pay the GST (i.e. output tax) charged on the goods sold to the intermediary businesses (i.e. the Buffers). The goods will ultimately be exported by the last supplier in the supply chain (i.e. the Exporter) to an overseas customer, with no GST charged as the

[2] An off-the-shelf company is an existing company that is already registered with the Accounting and Corporate Regulatory Authority (ACRA) but has never traded. Such company is ready for sale to someone who wants to set up a new company quickly.

[3] Any goods which attract GST can be used to commit MTF, although goods which are high in value, of low weight and readily available in large quantities (such as computer chips or precision parts) are commonly used.

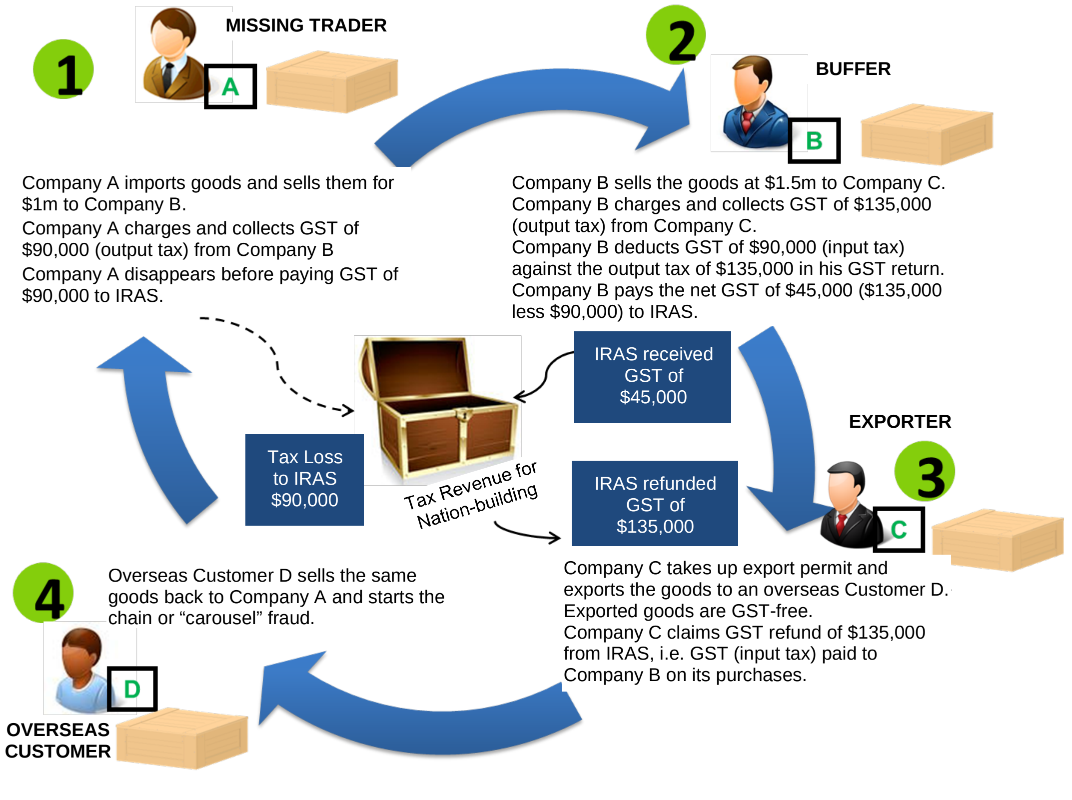
supply is zero-rated (0% GST). The Exporter then claims from IRAS the GST (i.e. input tax) which he, she or it paid on the purchase of the goods from the Buffers. Due to the failure of the Missing Trader in accounting for or paying the output tax, IRAS will suffer a tax loss if it pays the Exporter the input tax claimed.

This process can be repeated by re-importing and re-exporting the same goods – such an arrangement is also known as “carousel fraud”.

4.3 In some arrangements, the transactions only exist on paper and no goods are actually sold or exported. The appearance of the transactions is solely for the purpose of claiming fraudulent GST refunds.

4.4 Figure 1 below is an illustration of a simple MTF or carousel fraud arrangement.

Figure 1: Illustration of GST Missing Trader Fraud / Carousel Fraud



- Company A sells goods to Company B at $1 million and charges and collects GST (output tax) of $90,000 from Company B. Company A does not pay the GST of $90,000 to IRAS.

- Company B sells the goods to Company C at $1.5 million and charges and collects GST (output tax) of $135,000 from Company C. Company B deducts the GST of $90,000 (input tax) paid to Company A from the GST (output tax) of $135,000 collected from Company C and pays the net GST difference of $45,000 ($135,000 - $90,000) to IRAS.

- Company C exports the goods GST-free to overseas customer D and claims from IRAS the GST (input tax) of $135,000 which it had paid to Company B earlier. If refunded by IRAS, the tax loss to IRAS will be the amount of $90,000 ($135,000 - $45,000) that the Missing Trader fails to account for.

[GST amount is computed based on the prevailing GST rate of 9%.]

4.5 The links between participants in the supply chain are often disguised to make early detection difficult. For example, numerous buffer companies may be interposed in the supply chain in order to add distance between the missing trader and the exporter and obscure the entirety of the arrangement. Crime syndicates would also approach legitimate businesses to be part of the supply chain, attempting to pass off fraudulent transactions as legitimate offers with attractive business deals that would sound too good to be true. Employees of businesses may also collude with members of crime syndicates to approve such transactions for the businesses.

4.6 Businesses which are at risk of being implicated in MTF arrangements are often those that have failed to perform adequate and appropriate due diligence checks to ensure the authenticity of the transactions being entered into, or that choose to ignore obvious warning signs in order to earn a quick profit.

<u>Example 1: Illustration of an MTF arrangement interposed with numerous buffer companies and legitimate businesses</u>

Companies A, B, C, D, and E are GST-registered businesses. Company A (“Missing Trader”) supplies goods to Company B and charges GST on the price of the goods. Company B supplies the same goods to Company C at a higher price, allowing Company B to earn a profit margin, and charges GST on this price. The same supply of goods is simply passed on from Company C to Company D and then from Company D to Company E, with a higher price charged each time the goods are sold, with no material value added to the goods. Companies B, C and D (“Buffers”) are interposed to add layers between the Missing Trader and the Exporter.

> Company E ("Exporter") is asked to first buy goods from Company D and then sell the same goods to a pre-arranged overseas customer, Company F. Company E was promised an attractive deal with no commercial risk (e.g. guaranteed profits with back-to-back orders without the need to hold inventory, or the need to source for suppliers or customers) or no credit risk (e.g. upfront payment made by overseas customer before delivery of goods). All that is required of Company E is to simply pay for the GST upfront for the purchases made from Company D and thereafter, seek to obtain a refund from IRAS. Company E agrees to participate in this "too good to be true" deal, exports the goods zero-rated to Company F, and then submits a refund claim to IRAS.
>
> All the above-mentioned supplies are part of an MTF arrangement.

5 The Knowledge Principle

5.1 You may incur GST on your purchases (i.e. input tax) when purchasing from GST-registered businesses or when importing goods into Singapore. You may claim the input tax incurred, if you satisfy all the conditions[4] for making such a claim, by deducting the total input tax you have paid on your business purchases from the total output tax you have collected from your customers. The difference, called the net GST payable or net GST refundable, is what you will either pay to or receive (as a refund) from the Comptroller of GST ("Comptroller").

5.2 From 1 Jan 2021, you will not be entitled to any input tax on any purchase which you knew or should have known to be a part of an arrangement to cause loss of public revenue (i.e. the "Knowledge Principle")[5]. The input tax claim will be denied even though you may have satisfied all the other conditions for claiming input tax.

5.3 Under the Knowledge Principle, you **should have known** that a supply made to you is part of an arrangement to cause loss of public revenue if:

(a) The circumstances connected with the supply made to you or with a supply made by you, or both, carried a reasonable risk of the supply being a part of such arrangement; and
(b) Before making a claim for input tax on the supply made to you, you did not take reasonable steps to ascertain whether the supply was a part of such arrangement; or
(c) You took reasonable steps to ascertain whether the supply was a part of such arrangement and

[4] Please refer to paragraph 6.1.2 of the e-Tax Guide on "GST: General Guide for Businesses" for a list of conditions for claiming input tax.
[5] Sections 20(2A) and (2B) of the GST Act.

(i) concluded that the supply was not a part of such arrangement and the conclusion is not one that a reasonable person would have made;

(ii) was unable to conclude that the supply was not a part of such arrangement; or

(iii) did not make any conclusion as to whether the supply was or was not a part of such arrangement.

5.4 The test for whether you "should have known" that a supply was a part of an arrangement to cause loss of public revenue in paragraph 5.3 is an objective one. It focuses on the steps taken by you to assess the risks surrounding the transaction, and whether your conclusion that the supply was not part of such an arrangement was reasonable.

5.5 Businesses that took reasonable steps to reasonably assess that their transactions were not part of an MTF arrangement will not have their input tax claims denied if the conclusion is one that a reasonable person would have made.

<u>Three-pillar approach for applying the Knowledge Principle framework</u>

5.6 IRAS recommends that businesses adopt the following three-step approach to apply the Knowledge Principle framework:

Pillar 1: Identify and Assess Risk Indicators	**Pillar 2: Perform Due Diligence Checks**	**Pillar 3: Respond to the Risks and Results of the Checks**
• To identify the relevant circumstances connected with the supply, including the presence of risk indicators, that might suggest a likely connection with an MTF arrangement.	• To conduct adequate and appropriate extent and type of checks and enquiries required to mitigate the risks identified, using a risk-based approach.	• To take adequate and appropriate actions and precautions in response to the risk indicators and the results of the checks. • You should avoid participating in the transaction if it is suspected that the transaction is a part of an MTF arrangement.

6 Pillar 1: Identify and Assess Risk Indicators

6.1 Before entering into a business transaction, you should understand the circumstances surrounding the transaction, consider the relevant risk factors, and assess whether there is a reasonable risk that the supply made to you or by you might be a part of an MTF arrangement.

6.2 MTF transactions often present risk indicators that distinguish them from normal commercial practices. There are warning signs to prompt a business to conduct due diligence checks on the commerciality of the transactions and take actions or precautions in response to the indicators of risk. MTF risk indicators are commonly observed under the 4 key risk areas as follows:

(A) Legitimacy of your immediate customers and suppliers
(B) Commercial viability of the business arrangement
(C) Commercial viability of the payment arrangement
(D) Authenticity of the goods/services transacted

6.3 The list below highlights some common indicators under each key risk area that could alert and guide you to identify, consider, and assess the risks of the transaction being part of an MTF arrangement. This list is not exhaustive and will be updated by IRAS as may be necessary. Businesses are advised to be alert to transactions and arrangements that deviate from normal commercial practices and expectations within your industry.

<u>Risk Area (A): Legitimacy of your immediate customers and suppliers</u>

- High-value deals offered by a newly established supplier
- Supply is not within the nature of the business ordinarily carried on by the supplier/customer
- Minimal or no effort required by you to source for your customers and suppliers with deals being pre-arranged, e.g.
  - You are contacted within a short span of time by both a prospective buyer and a prospective seller offering to buy/sell goods of same specifications and quantities
  - You are referred to a customer who is willing to buy goods of the same quantities/specifications being offered by a seller, whereby the need for your business as an intervening supplier would appear unnecessary
- Minimal or no effort on your part to effect the purchase or sale, e.g. day-to-day sales and purchase decisions handled by someone else
- Same address used by different transacting parties or other address inconsistencies
- Unexplained or unnecessary parties to the transaction and who appear evasive about their identities upon further enquiries
- Despite the substantial value of transactions, the supplier or the supplier’s own supplier (if disclosed) may be newly incorporated with limited background information/financial information regarding the company, or may exhibit a lack of business presence, or may have experienced a change in ownership
- Difficulty in authenticating the identities of the persons representing the customers and suppliers, as most instructions are provided either verbally or through instant messaging platforms.

Risk Area (B): Commerciality of the business arrangement

- High volume and value of goods transacted relative to the market demand and price
- High-value deals offered with no formal contractual arrangements
- Consistent or pre-determined profit margins, irrespective of the date, quantities, or specifications of the goods/services being traded
- Normal commercial practices not adopted in negotiating prices
- Very low commercial risks involved in the business arrangement. For example:
  - Deals were undertaken on a back-to-back basis over a short time period whereby the same quantity of goods that were purchased, were sold within a very short period of time
  - No necessity to hold inventory or to source goods from any other suppliers

Risk Area (C): Commerciality of the payment arrangement

- Very low credit risks that do not commensurate with usual commercial expectations, e.g. payment to supplier due only after receiving payment from customer, upfront payment in full by customers before goods delivery
- Payment arrangements that have higher risks of being linked to money-laundering activities, e.g.:
  - Cash-only transactions
  - Payment for high-value supplies is split over a short period of time, such that although the amount of each payment to supplier is not substantial, the cumulative total of the payments is substantial
- Supplier requiring you to make payments to a third party or to an offshore bank account
- Customer makes payments to you through a local paying agent or third party's bank account

Risk Area (D): Authenticity of the goods/services transacted

- Source and authenticity of the goods are unclear (e.g. brand, manufacturer, country of origin)
- No assurance on the quality, condition, and specification of the goods, which is backed up by written warranty policies
- No insurance taken for goods during shipment, despite the substantial value of the transaction
- No clear indication of the arrangement regarding movement of goods, e.g. the party who is liable for the goods during the transportation journey

While the presence of a single risk indicator does not necessarily imply that the transaction is a part of an MTF arrangement, the presence of multiple risk indicators would be indicative of a suspicious transaction.

6.4 Businesses should also be aware of any change in circumstances or new risk factors. For example, there may be clear indications that the risks associated with an existing business relationship have increased based on material trigger events [6]; businesses should therefore re-assess the legitimacy of the business arrangement concerned and make further enquiries to determine if further actions or precautions are necessary.

7 Pillar 2: Perform Due Diligence Checks

7.1 Identification of the risk areas and assessment of the overall risk of the transaction (from Pillar 1) should prompt due diligence checks and enquiries where necessary. Where there is a reasonable risk that the supply is a part of an MTF arrangement, it is in the interest of the business to take adequate and appropriate actions or precautions to address the risks identified, before choosing to participate in the supply.

7.2 Businesses may adopt a risk-based approach in assessing the extent of due diligence required to establish the integrity of the supply chain. This should be commensurate with the type and level of risks identified. For example, more extensive due diligence measures would be required for higher risk transactions in order for the business to reasonably ascertain whether or not the supply is a part of an MTF arrangement. Conversely, lower risk transactions, such as those with commercially viable circumstances that do not deviate from usual practices, may require less extensive checks for the business to reasonably conclude that the supply is not a part of an MTF arrangement.

7.3 The **non-exhaustive** list below provides examples of due diligence checks and enquiries that can be made in light of the risk indicators, so as to guide you in establishing the integrity of the transactions. It is critical that you ask the most appropriate questions required to protect yourself from getting implicated in an MTF arrangement.

[6] Such material trigger events include, but are not limited to, any change in business representatives involved in the transaction, changes in details of products transacted, significant increase in transaction volume or value, and adverse news concerning business partners.

(A) Verify the legitimacy of the immediate parties that you are transacting with

Know your supplier/customer

- Maintain the details of your supplier/customer and check that the details provided are genuine by verifying against other reliable sources (e.g. website, registered business profile)
- Check the supplier's/customer's relevant experience in the trade and its knowledge of product/market. If the transaction is inconsistent with the supplier's/customer's profile, find out if there is a reasonable explanation for the inconsistencies observed
- Obtain trade references and follow-up with them
- Obtain credit checks or other background checks from an independent third party
- Visit your supplier's/customer's premises

Third Party Situations

In situations where there is a third party involved in the business arrangement, you should ensure that you know who you are liaising with:

- Maintain details (e.g. full name, designation and contact) of the person(s) who contacted you regarding the business transactions
- Verify with the supplier or customer on the identity of the person(s) representing them and the capacity in which they are acting on behalf of your supplier or customer, and if there are legitimate reasons for such representation

(B) Ascertain the commerciality of the business arrangement

Understand the market that you are transacting in

- Understand the market demand and price of the goods, and whether the volume and value of goods transacted is reasonable and realistic relative to the market demand and price
- Consider whether it is realistic for a relatively new business to be able to sell the goods at the rates proposed
- If the transaction involves overseas shipment of goods (import/export), consider whether the arrangement makes economic sense (e.g. whether it is inconsistent with normal geographic trade patterns or whether it is reasonable that the country involved would normally import or export such goods)
- Understand if there is a reasonable explanation for the low commercial risks involved in the business arrangement (e.g. find out the reason why there is no necessity to keep inventory or source goods from other suppliers)

- Identify the commercial purpose for your involvement in the business arrangement (e.g. the value-add provided by you to the business arrangement)

<u>(C) Ascertain the commerciality of the payment arrangement</u>

- Find out if the payment terms are in line with commercial practice and if not, find out if there is a reasonable explanation
- Establish if there is any commercial justification for payment arrangements that are out of the norm (e.g. cash-only transactions, payment to offshore accounts)
- If payment was made by third party, find out the relationship between the third party and your customer and the reasons for the arrangement
- Notice any inconsistencies in the information (e.g. names, companies, addresses, ports of call and destination) contained in the trade documents and financial flows

<u>(D) Verify the authenticity of the goods/services transacted</u>

Understand the goods/services that you are transacting in

- Know the source of the goods that you are transacting in (e.g. brand, manufacturer and origin of the goods)
- Verify that the goods supplied are the same goods as described in the tax invoices and that the goods are in working condition
- Verify that the customers' testimonials or reviews are credible and reliable
- Is there any recourse if the goods or services supplied are not as described? If not, find out if there is a reasonable explanation
- Check on the insurance and warranty arrangements or service agreements. If these are not available, find out if there is a reasonable explanation

Understand the arrangement regarding movement of goods

- Maintain the details of the freight forwarder
- Understand the details of the transportation arrangement, e.g. your liability and the ownership of the goods throughout the transportation journey
- Verify that the goods are shipped to and received by your customer as described and transacted
- Notice any abnormalities in your commercial and transport documents without any reasonable justification, e.g.
  - Discrepancies between the commercial and transport documents (e.g. description of goods, destination, quantity of goods)
  - Unusual weight descriptions for the goods compared to the quantity of the goods exported

- Inappropriately sized or non-typical type of vessel used to transport the goods

> *You may find that most of the due diligence checks in paragraph 7.3 are already part of your existing business risk management processes. IRAS recommends that adequate and appropriate checks are carried out in each of the above categories where the risks are identified to protect yourself from being implicated in an MTF arrangement. The types and extent of the checks will vary depending on the individual circumstances of your business as well as the nature and size of transactions.*

7.4 Example 2 illustrates a scenario where the circumstances connected with the supply carried a reasonable risk of the supply being a part of an MTF arrangement, but the business had failed to take reasonable steps to ascertain whether the supply was a part of such arrangement.

<u>Example 2: Input tax claim denied under the Knowledge Principle – the taxable person should have known that the supply made to the taxable person was a part of an arrangement to cause loss of public revenue</u>

Company X is a GST-registered company since 1 Jan 2009. It provides mechanical and engineering works.

(a) Introduction to the 'business opportunity' and business partners

- In Jan 2021, Tan (who is the sole-director of Company X), was approached by his ex-colleague, Lim. Lim told Tan that he was looking for an interested party to take over his export business in computer parts as his company was facing cash flow issues.
- Lim shared with Tan that he had standing weekly orders of computer parts from his regular overseas customers. Lim also referred Tan to Koh from Company Z whom he usually purchases the goods from.
- Tan understood from the discussions that he could alleviate Lim's cash flow issues by taking over Lim's export business and reclaiming from IRAS the GST paid on the purchases of goods. In return for the no-risk deal, he would be able to obtain a guaranteed profit margin.

! *Risk Area (A): Consider the legitimacy of your immediate customers and suppliers*

(b) Business arrangement

- Lim presented to Tan the attractive and no-risk business opportunity with a guaranteed profit margin of 2%. The business deal would involve high volume and high value of goods transacted with total export sales value of about $500,000 per month.

- When orders for the computer parts were received from the overseas customers, Tan would place orders for the goods with Company Z through Koh. Tan applied a mark-up in its quote to the overseas customers. Tan was given the assurance that the deals could take place quickly, with sales turnaround of about 2 to 3 days from the receipt of goods delivered by Company Z to the export of goods by Company X to the overseas customers.

! *Risk Area (B): Consider the commerciality of the business arrangement*

(c) Payment arrangement

- In terms of payment for the goods by the overseas customers, after tax invoices had been issued by Tan to the overseas customers, cash payments via direct bank transfers were made to Company X's bank account through a third party (i.e. payment terms of 'Payment before goods delivery").
- Lim told Tan that Company X would not be required to pay for the goods purchased from Company Z until after Company X received payment from its overseas customer.

! *Risk Area (C): Consider the commerciality of the payment arrangement*

(d) Authenticity of the goods/services transacted

- Despite the high value of transactions, Lim did not provide any assurance to Tan regarding the quality of the goods, or any warranty arrangements, or any insurance necessary for the export of the goods.

! *Risk Area (D): Consider the authenticity of the goods transacted*

Tan agreed to take over the export business involving about 10 exports per month with average sales value of $50,000 per export, without performing any further due diligence checks or enquiries.

Tan sought to claim the input tax incurred on his purchases from Company Z by filing the claims in the GST returns. During IRAS' review of the refunds, the transactions involving computer parts were found to be part of an MTF arrangement. Having regard to all the circumstances of the case, Company X's input tax claims in relation to the purchases of computer parts from Company Z will be denied by IRAS as Company X should have known that the purchases were part of an arrangement to cause loss of public revenue:

- From the risk indicators presented, the circumstances connected with the supplies should have led a reasonable person to assess that the deals were too good to be true and that there was a reasonable risk that the supplies were part of an MTF arrangement. This should have prompted Company X to perform the necessary due diligence checks and enquiries to establish the legitimacy of the transactions.

- However, Company X did not act on the risks; it did not take adequate and appropriate actions and precautions in response to the risks identified and thus could not reasonably conclude that the supplies were not part of an MTF arrangement. Unfortunately, Company X chose to proceed with the deals as it was a good opportunity to make a quick gain.

Examples of due diligence checks that Company X could have undertaken in response to the risks identified are:

Due Diligence Areas	**Examples of good due diligence**
(A) Verify the legitimacy of the immediate customer and supplier	• Obtain business incorporation details regarding Company Z and the overseas customers • Perform credit checks or other background checks on Lim's company, Company Z (i.e. supplier) and the overseas customers (e.g. by checking their websites) • Check if Company Z and the overseas customers have the relevant experience in the trade and product/ market knowledge • Ask for trade references and follow up with these references to ensure that Company Z and the overseas customers are reliable • Visit the business premises of Lim and Company Z • Maintain details (e.g. full name, designation and contact) of the contact persons linked to the business transactions • Verify the identity and capacity of the person representing the supplier (i.e. Koh) and the overseas customers
(B) Ascertain the commerciality of the business arrangement	• Understand the market demand and price of the goods – e.g. is the volume and value of goods transacted (i.e. average export sales value of $50,000 per month) reasonable and realistic relative to the market demand and price? • Are the mark-ups within the supply chain commercially viable? If not, what could possibly explain the high guaranteed profit margin of 2%?

(C) Ascertain the commerciality of the payment arrangement	• Are the payment terms e.g. “Payment before goods delivery” in line with commercial practice? - Is there any commercial justification for the cash-only payment by the overseas customers? - Is there any commercial justification for the payment to be made through third party? - Is there any commercial justification for the payment to be made to Company Z only after payment had been received from the overseas customers?
(D) Verify the authenticity of the goods/services transacted	• What is the brand, manufacturer and country of origin of the goods in question? • Do the goods exist and are they in working condition? • Are there insurance and warranty arrangements as safeguards given the large value of the goods? If not, why?

8 Pillar 3: Respond to the Risks and Results of the Checks

8.1 Businesses are advised to take adequate and appropriate actions and precautions in response to the risk indicators and results of the checks. This includes making further enquiries if the results of the checks are unsatisfactory.

8.2 You should avoid participating in the transaction if it is suspected that the transaction is a part of an MTF arrangement. For transactions entered into, you should be able to show that reasonable steps have been taken and that you can reasonably conclude that the supply was not a part of an MTF arrangement, based on the risks assessed and results of the checks.

Performing cursory risk assessment and due diligence checks without taking into account the context is not enough to detect MTF. Businesses that choose to ignore warning signs and fail to exercise due diligence or make reasonable judgments could risk having their input tax claims denied under the Knowledge Principle if their transactions are found to be part of an arrangement to cause loss of public revenue. Walk away from deals if they appear too good to be true or if you have reason to suspect the deals are fraudulent.

8.3 Example 3 illustrates a scenario whereby a business had failed to act upon the risks identified and the results of the checks, and thus it was not reasonable for the business to conclude that the supply was not a part of an MTF arrangement.

Example 3: Results of checks dismissed and ignored

Company X is an experienced trader in electronic goods. Chan, who is the sole director of Company X, was approached by Ong (representative of Company Y) to participate in an attractive business deal.

Ong shared with Chan that Company Y has an ongoing deal with Overseas Customer Z involving the supply of electronic goods, and has ready contacts of local companies ("Exporters") who are willing to export the goods to the Overseas Customer Z. Ong claimed that Company Y does not have the resources to manage the huge volume of transactions and would like to share this business opportunity with Company X.

Ong would introduce the Exporters to Chan if Chan agrees to participate in the business deal. Company X's role is to receive and fulfil the orders for the goods from the Exporters by first purchasing the goods from Company Y, and then sell the goods to the Exporters at an agreed profit margin. Company X does not need to hold any inventory as the goods will be delivered directly by Company Y to the premises of the Exporters within the same day. Payment to Company Y for the purchases would be due only after receiving payment from the Exporters.

Company X conducted due diligence checks on Company Y and the business proposals. The results of the checks revealed that:

- Company Y has poor credit rating.
- Company Y's GST registration showed that its registered business activity is that of trading in an activity (i.e. beauty products) which is a completely different business activity from the supplies being undertaken (i.e. electronic goods).
- Company Y could not reasonably explain why there is such a huge and consistent stream of demand from overseas customer Z.
- Company Y refused to provide further information on the Exporters unless Company X agrees to participate in the business deal, citing business reasons. Company Y also refused to provide further information on the source of the goods.

Despite the risks identified from the checks, Company X did not act upon the risks and decided to proceed with the deals as it was a good business opportunity not to be missed.

Given the risks identified from the checks, it was not reasonable for Company X to conclude that the purchases were not part of an arrangement to cause loss of public revenue. Company X should not have proceeded with the deals. As such, Company X's input tax claims in relation to the purchases of electronic goods will be denied by IRAS.

9 Keeping proper records

9.1 You should maintain records of the steps taken to ascertain whether the supply made to you was a part of an arrangement to cause loss of public revenue. This includes the risks assessed, the due diligence checks performed, and your actions and precautions taken in response to the results from the checks. The information should be readily available upon request by IRAS.

9.2 Keeping proper records can help you to achieve the following objectives:

- Ensure proper monitoring and accountability for supplies entered into and decisions made;
- Demonstrate that the supplies entered into were not part of an arrangement to cause loss of public revenue and that the conclusion is a reasonable one; and
- Help provide timely, complete, and accurate replies to our requests for information in the case of an MTF audit or investigation by IRAS.

10 Input tax claims subject to IRAS' audits or investigations

10.1 You will be informed by IRAS if your input tax claims are subject to IRAS' audits or investigations under the Knowledge Principle. Where applicable, IRAS will notify you, within 3 months after the receipt of all the information requested from you, that your refund claims have been withheld.

In circumstances where IRAS needs to investigate into the claims, these investigations will have to be thorough, especially since the arrangement is suspected to be fraudulent. Such investigations will require sufficient time given the complexity of Missing Trader Fraud arrangements and also the existence of multiple third parties.

10.2 IRAS will work with you to seek to identify and understand the due diligence checks and the actions or precautions taken by you in response to the risks identified and the results of your checks. IRAS will consider:

- the due diligence checks that were conducted by you, including any checks designed to address the specific risks;
- to what extent your checks were adequate, appropriate, and timely in addressing the risks identified; and

- the results of your checks, the conclusions made by you in response to the results and the actions taken by you.

10.3 In applying the Knowledge Principle, IRAS does not expect a business to go beyond what is reasonable. The business should assess the adequacy and extent of their risk assessments, due diligence checks and documentation by evaluating the following factors based on the facts and circumstances of their situation:

(a) Whether there is a reasonable risk of the supply being a part of an MTF arrangement; and
(b) Whether the business is able to demonstrate compliance with the requirements under the Knowledge Principle framework.

Your input tax claims will not be denied under the Knowledge Principle if you:
- *took reasonable steps to ascertain whether or not the supply was a part of an arrangement to cause loss of public revenue, and concluded that the supply was not a part of such an arrangement; and*
- *the conclusion is one that a reasonable person would have made*.

10.4 If your input tax claims are denied under the Knowledge Principle, IRAS will send you a decision letter with reasons as to why the Comptroller is of the view that you knew or should have known that the supply was a part of an arrangement to cause loss of public revenue.

10.5 If you disagree with the Comptroller's tax assessment under the Knowledge Principle, you may apply for a review and revision of the assessment under Section 49 of the GST Act. A valid objection must:
- be made in writing to the Comptroller of Goods and Services Tax;
- state the detailed reasons for objecting;
- be made within the stipulated time limit i.e. within 30 days of the Notice of Assessment; and
- be signed and dated.

10.6 The Comptroller will consider your application for review and revision, and thereafter inform you of the Comptroller's decision regarding your application for review and revision. If you disagree with the Comptroller's decision regarding your application for review and revision, you may appeal by lodging a written notice of appeal with the secretary of the GST Board of Review within 30 days from the date of the Comptroller's decision. In addition, you must also lodge a petition of appeal stating the grounds of your appeal within a further 30 days of the date on which you lodged your notice of appeal.

11 Frequently Asked Questions

Q1 Is the Knowledge Principle applicable to specified goods only?

A1 No. The “Knowledge Principle” is not goods-specific and is applicable to any category of goods or services that has been supplied to a taxable person, who knew or should have known that by his, her or its purchase, he, she or it was taking part in a transaction that was a part of an arrangement to cause loss of public revenue.

Q2 Do I have to complete all the due diligence checks listed in this e-Tax Guide? Can IRAS tell me exactly what checks should I undertake?

A2 Not necessarily. The examples in this e-Tax Guide are only guidelines for the types of checks that you can make to help you avoid participating in an MTF arrangement. You should assess the appropriate type and extent of checks you will need to make using a risk-based approach. Hence, the appropriate checks can vary depending on the circumstances of your trade and the nature of your transactions.

Q3 Am I expected to conduct checks beyond my immediate customers and suppliers under the Knowledge Principle?

A3 No. You are not expected to conduct checks on your non-immediate customers and suppliers, provided that you have no connection or direct dealings with them. Even if your non-immediate customers or suppliers were found to be part of an MTF arrangement, your input tax claims will be assessed under the Knowledge Principle based on the due diligence checks you performed on your immediate customers, immediate suppliers and the goods/services involved. However, please also see Q4 below.

Q4 Does it mean that my input tax claims will not be denied under the Knowledge Principle so long as I have conducted due diligence checks?

A4 Not necessarily. Under the Knowledge Principle, the relevant question is not only whether the taxable person has conducted due diligence checks but also whether the taxable person knew or should have known that the supply was a part of an arrangement to cause loss of public revenue. Even if the business has conducted adequate and appropriate due diligence checks, its input tax claim may be denied if it chooses to proceed with the transaction despite the results of the checks suggesting that the transaction might be a part of an MTF arrangement (e.g. Example 3).

Your input tax claims will not be denied under the Knowledge Principle if you:

- took reasonable steps to ascertain whether the supply was a part of an arrangement to cause loss of public revenue and concluded that the supply was not a part of such an arrangement; and
- the conclusion is one that a reasonable person would have made.

Q5 What if my customer/supplier refuses to provide me with additional information?

A5 You should consider not proceeding with any transaction involving any customer/supplier who is vague or who refuses to provide information and documents which are normally required in the course of business relations. You should pay closer attention to parties who provide minimal, false or misleading information.

Q6 Does the enactment of the Knowledge Principle mean that I need to perform due diligence checks on all my existing business relationships? Do I need to continuously monitor my business transactions?

A6 For existing business relationships, you may rely on due diligence measures already performed, unless the transactions present red-flag indicators of a likely connection with MTF or if there are material trigger events. Examples of such material trigger events include, but are not limited to, significant increase in transaction volume or transaction value with no reasonable explanation, material additions or changes in the nature of goods or services transacted, changes in business representatives involved in the transaction, or adverse news on business partners.

As part of good corporate governance, ongoing monitoring should be conducted in all business relationships. Nevertheless, the depth and extent of monitoring of business transactions can vary depending on the counterparty's risk profile, and higher-risk counterparties should be subject to more stringent monitoring.

Q7 Will I be required to pay additional sums if my input tax claims have been denied by IRAS under the Knowledge Principle?

A7 Yes. Businesses that have their input tax claims denied on the ground that they **should have known** that their purchases were part of an arrangement to cause loss of public revenue will have to pay a surcharge of 10% of the amount of input tax denied. For example, if the amount of input tax denied is $50,000, a surcharge of $5,000 will be payable (on top of the additional tax assessed).

On the other hand, businesses that have their input tax claims denied on the ground that they **knew** that their purchases were part of an arrangement to cause loss of public revenue may be prosecuted under section 59 or section 62 of the GST Act whereby a penalty will be imposed upon conviction.

Q8 What should I do if my checks show signs of a possible connection with an MTF arrangement?

A8 If your checks show signs of a possible connection with an MTF arrangement, you are advised to not continue with the transaction as your input tax claim may be denied if the transaction is found to be a part of an MTF arrangement. You may report your suspicion to IRAS via email to ifd@iras.gov.sg or use the reporting template <Reporting Tax Evasion>[7].

12 Contact Information

12.1 For enquiries on this e-Tax Guide, please contact the Goods and Services Tax Division at www.iras.gov.sg (select "Contact Us").

13 Updates and Amendments

	Date of Amendment	Amendments made
1	1 Jan 2023	Updated paragraph 4.4 to reflect the increase in GST rate from 7% to 8% from 1 Jan 2023
2	1 Jan 2024	Updated paragraph 4.4 to reflect the increase in GST rate from 8% to 9% from 1 Jan 2024

[7] Please refer to IRAS website at https://www.iras.gov.sg > GST > GST-registered businesses > Getting it right > Tax Evasion or Fraud.

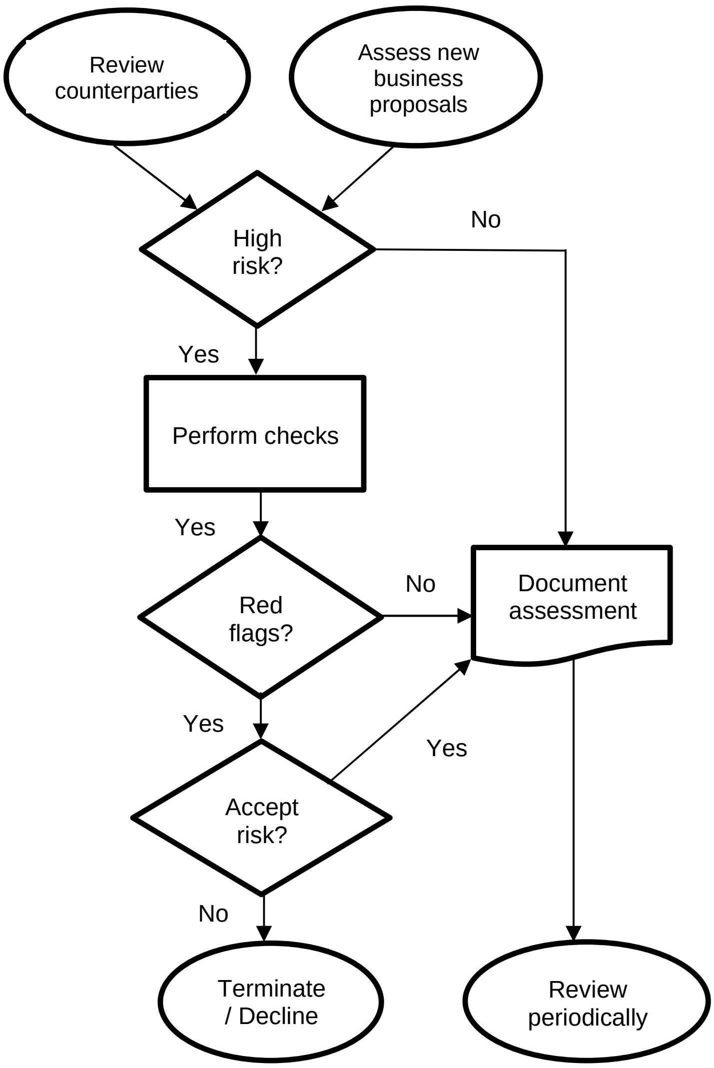
Appendix A – An Example of Risk Management to Avoid Being Involved in Missing Trader Fraud

1) **Integrate risk management of MTF into your existing governance framework**
Identify a process/risk owner who is accountable for MTF risk management and ensure that the risks are mitigated by implementing a process to identify, assess and understand MTF risks.

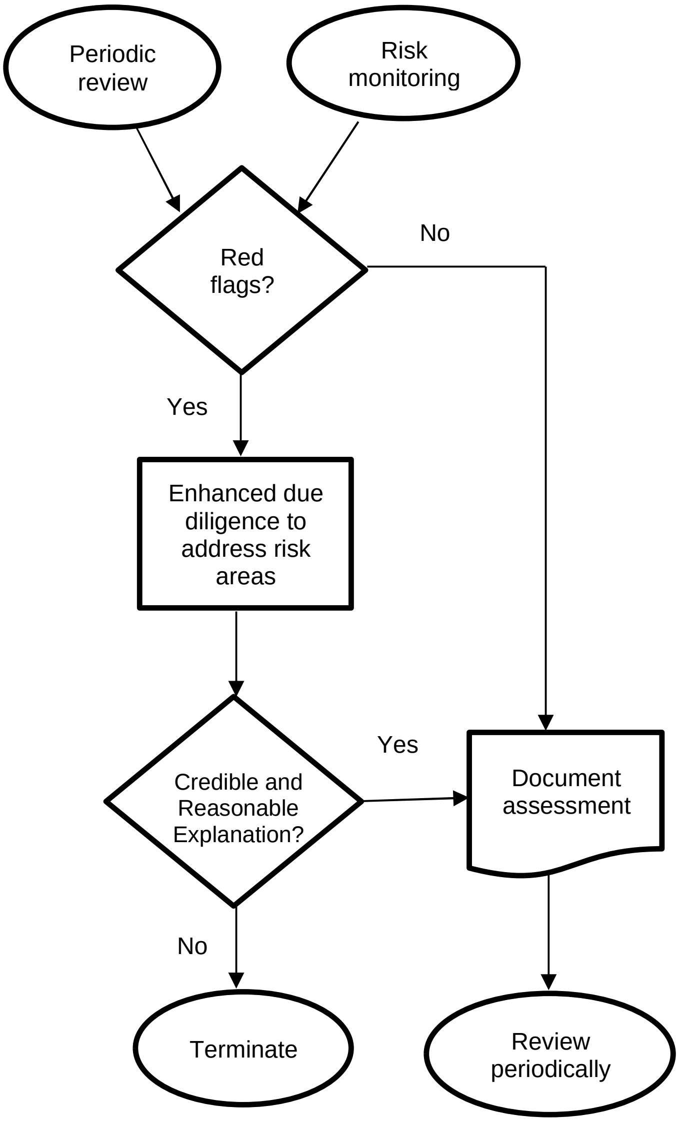
2) **Conduct a risk assessment**
Take reasonable steps to identify any exposure to MTF risks. If your risk assessment suggests potential MTF exposure, more detailed checks are required to capture and record the risks and determine the appropriate counter measures. See Flowchart 1.

Perform ongoing monitoring of counterparties and transactions to identify risk indicators or changes of behaviour which may emerge after the initial assessment. See Flowchart 2.

Flowchart 1: Risk assessment of new and existing counterparties as well as business proposals



Flowchart 2: Ongoing monitoring of counterparties and transactions



3) Awareness and training

Provide effective training to employees across all levels and functions so that they can recognise the risk indicators of MTF and know who to contact to prevent or minimise the impact of MTF to your business.

Awareness training can be focused on employees from the high-risk business units, such as procurement and sales, logistics and accounts, as well as those performing governance and compliance functions such as Chief Compliance Risk Officer or Internal Audit Officer.